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## Introduction

¶1. (U) We look forward to your visit May 27-29 to participate in the National Competitiveness Forum we are organizing with the Ministry of Trade, Industry, and Development and the investment promotion agency ProNicaragua. Recent visits to Nicaragua by Department of Commerce Under Secretary Christopher Padilla and Assistant U.S. Trade Representative Everett Eissenstat underscored the importance of CAFTA-DR for Nicaragua (Refs C and E). With the Forum, we would like to reinforce that message and focus the national dialogue on the role of the government in improving competitiveness to take advantage of market access offered by CAFTA-DR. We hope that this forum will serve as useful preparation for Nicaraguan participation in Commerce Secretary Gutierrez' August 2008 Americas Competitiveness Forum in Atlanta.

## U.S. - Nicaragua Relations

¶2. (U) The Embassy continues to engage with the Nicaraguan Government on areas of common interest, despite President Daniel Ortega's frequent public criticism of the United States. The military and National Police remain relatively independent, apolitical forces, and our cooperation with these institutions to counter terrorist and criminal threats remains good. We also support those elements of Nicaragua's civil society, private sector, political class, and government willing to defend Nicaragua's fragile democracy. USAID's program supports efforts to strengthen democracy; promote economic growth, especially through market-driven assistance for small farmers; and improve education and health care systems. MCC is in the third year of a five year, $175 million compact that promotes rural business development, transportation infrastructure, and property registration. USDA assistance provides financing to small farmers and supports government programs on sanitary and phytosanitary standards for food exports. U.S. Treasury provides important technical assistance on debt management and tax collection, while an extensive Peace Corps program supports rural development and English-language teaching.

## Foreign Policy

¶3. (C) Ortega has pursued very close ties with Venezuela and opened cooperative relations with Iran. Immediately after his inauguration, Ortega signed on to Chavez' Bolivarian Alternative for the Americas (ALBA), and in late 2007 he concluded an agreement with Venezuela that redirects up to 50% of oil purchases to development programs. Opposition leaders and democracy watchdog groups complain that there is no transparent accounting for this off-budget funding. President Ortega quickly sided with Venezuela and Ecuador to briefly break relations with Colombia in March over Colombia's strike into Ecuador against the FARC. Despite reciprocal state visits, Iran, has signed no investment deals nor responded to Ortega's request to forgive sovereign bilateral debt. On the multilateral front, President Ortega appears likely to succeed in having ardent U.S.-hater and former Foreign Minister Miguel d'Escoto chosen to serve a one-year term as U.N. General Assembly President beginning September 2008.

## Political Climate

¶4. (C) President Ortega has skillfully used his political pact with former President and convicted Felon Arnoldo Aleman to wrest control over all branches of government and blur the distinction between party and state. The centerpiece of Ortega's "second phase of the revolution" is the introduction of Qadhafi-style "direct democracy" in Nicaragua through the establishment of Citizen Power Councils (CPCs). These groups, nominally representing civil society, but in fact directed by First Lady Rosario Murillo, are bypassing elected municipal governments and increasingly assuming a leading role in the distribution of FSLN patronage such as housing and discounted food.

¶5. (C) November 2008 municipal elections dominate the political landscape at this time. Ortega's FSLN party will face a tenuous opposition all

## Macroeconomic and Financial Outlook

¶6. (C) Although critical of free trade and capitalism, Ortega has maintained the legal and regulatory underpinnings of the market-based economic model of his predecessors. Economic growth for 2007 was 3.7% and is forecast for 3.8% in 2008, though many independent economists forecast something closer to 3.0%. Under an International Monetary Fund program signed in October 2007, the Nicaraguan Government agreed to implement free market policies linked to targets on fiscal

discipline, spending on poverty, and energy regulation. However, Ortega's frequent populist rhetoric calls into question his government's commitment to these targets. Inflation is on track to exceed 22% this year, boosted by rising fuel prices and a 30% increase in the minimum wage for most occupations. The lack of a strong policy response to rising inflation is worrisome, given the likelihood that off-budget Venezuelan assistance has created excess liquidity.

¶7. (C) In an effort to discredit opposition leader and former Finance Minister Eduardo Montealegre, on April 15, 2008, the government refused to pay principal and interest due on bonds (Negotiable Investment Certificates, CENIs) issued in 2001 to compensate healthy banks for absorbing the assets and liabilities of insolvent banks (Ref D). As a consequence, recent improvements in Nicaragua's sovereign credit rating, thanks to a series of debt relief programs and support from U.S. Treasury, are at risk. Other policy measures reflect similar political motivations. For example, the government disbanded a successful agricultural development program that provided improved seeds and technical assistance to farmers in favor of a program that provides a families identified by local CPCs with livestock and unimproved seeds. Budget execution remains far below targets, leaving needed infrastructure and other capital projects on the drawing board.

Trade and Investment
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¶8. (U) On April 1, 2006, CAFTA-DR entered into force for the United States and Nicaragua. Nicaraguan exports to the United States, which account for 55% of Nicaragua's total exports, were $1,608.4 million in 2007, up 36.3% from 2005. Textile and apparel account for 60% of those exports, while automobile wiring harnesses add another 10%. Other leading export products are coffee, meat, cigars, sugar, ethanol, and fresh fruits and vegetables--all of which have seen remarkable growth since CAFTA went into effect. U.S. exports, meanwhile, were 846.8 million in 2007, up 43.6% from
¶2005. Other important trading partners for Nicaragua are its Central American neighbors, Mexico, and the European Union, with which it is negotiating a trade agreement as part of a Central American bloc.

¶9. (C) Foreign investment inflows totaled $337 million in 2007, including U.S. firm Cone Denim's $100 million mill (Ref A) and Mexican and Spanish investment of $120 million in telecommunications infrastructure. However, despite important protections for investment included in CAFTA-DR, the investment climate has steadily worsened since Ortega took office. On more than a dozen occasions, the government has used its tax, customs, and property administrations to pressure individuals and companies into accepting noncommercial terms in concessions or contracts. Uncertain property rights also contribute to the deterioration of the investment climate, especially for tourism investment.

¶10. (C) For the first time, employment has fallen in the all-important apparel manufacturing sector. One large Taiwanese apparel manufacturer recently announced plans to shutter its plants, eliminating 14,000 jobs, and 2 other firms closed operations in late 2007. Hanes Brands recently announced it had canceled plans to establish a manufacturing facility here.
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